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GLOBAL ECONOMIC DEVELOPMENTS - 1999

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Executive summary

World economic growth gained momentum in 1999 increasing by 3.3 per cent, impelled by vibrant activity in the United States and Asia. The robust United States expansion continued with real Gross Domestic Product (GDP) growing by 4.2 per cent. The European Area with growth of 2.3 per cent experienced similar dynamism. In both of these economies strong GDP growth was matched by firm gains in employment. Growth was also more robust in developing countries, as a whole, but showed important disparity by region. Buoyed by competitive exchange rates and strong demand in the United States and the European Area, growth rebounded strongly in the Asia-Pacific region. This contrasted with declining growth performance in Africa, the Middle East and Europe and Latin America and the Caribbean.

Economic growth in Sub-Saharan Africa continued to be imperiled by declining commodity prices, poor investor confidence and disruptions occasioned by war and adverse weather. Meanwhile, growth slipped in Latin America and the Caribbean, as the impetus in Mexico, Central America and a few Caribbean countries was dampened by sluggish output growth and export performance in the Southern Cone Common Market (MERCOSUR) subregion. Growth rates of 0.5 per cent in Brazil and a decline of 3.5 per cent in Argentina, contrasted with 3.5 per cent growth in Mexico. Caribbean countries' growth performance was strongly influenced by the export multiplier. Growth in the Dominican Republic (8.2 per cent), Belize (6.2 per cent) and Trinidad and Tobago (4.2 per cent) was stimulated by their ability to take advantage of the booming United States market, while Jamaica (-0.4 per cent), the Organisation of Eastern Caribbean States (OECS) and Suriname, whose exports were relatively uncompetitive, recorded weaker growth. OECS banana exports were hard hit, contracting by almost 8 per cent in 1999. Inflation was also subdued in most regions, except the Countries in Transition, where bottlenecks led to a doubling of the rate.

World trade rebounded in 1999, and was indeed the main engine of growth. The impetus for the improvement in trade was largely provided by the Asian economies that staged v-shaped recoveries. Merchandise trade also picked up in Latin America and the Caribbean, bolstered by the competitive strength of Mexico and Central America. By contrast, merchandise exports declined in Africa and the Transition economies by 15.5 per cent and 1.5 per cent, respectively, precipitated by weakened commodity demand and prices. In the services sector, tourism gained momentum, growing by 4.1 per cent, up from 3.1 per cent in 1998. The United States continued to garner the lion's share of tourism receipts. This suggests that developing countries, such as those in the Caribbean, need to diversify and revitalize their tourism product and service to improve their market share in the sector.

There was a flurry of activity on the institutional and trade negotiation fronts in 1999, aimed mainly at promoting regionalism and financial regulation. The World Trade Organization (WTO) held its Third Ministerial Meeting in Seattle, Washington, to advance the millennium round of trade negotiations, with the main focus on the liberalisation of agriculture and services,

the unfinished agenda from the Uruguay Round and also new issues. However, the meeting was largely unsuccessful due to disagreements among developing and developed countries over the vital issues for focus and disruptive protests by labour and environmental lobby groups. A crowning achievement of European integration, the euro, was launched as the future currency of the integration bloc.

Notably, the groundwork for the African Caribbean Pacific-European Union (ACP-EU) Partnership Agreement, the successor to the Lomé IV Agreement, was laid in 1999, and the agreement was signed in June of 2000. The agreement provides for a strengthened partnership based on poverty reduction and structured integration of the ACP countries into the world economy. In addition, the preferential access to the United States market was extended to the Caribbean through the Caribbean Basin Trade Pact (CBTPA) that was passed by the United States Congress in May 2000. This should provide important market access for competitive textile, apparel, fish and other products from the Caribbean.

Financial reforms centred on strengthening financial institutions and regulatory arrangements to limit the prospect of future crises. The Financial Stability Forum was mandated to undertake work in this area.

Financial conditions also improved, buttressed by strengthened investor confidence and equity prices. However, net private capital flows seem still to be affected by some investor uncertainty and, probably, better discrimination between countries with high and low risk profiles. World saving was stable at roughly 23.2 per cent of GDP in 1999. Saving in advanced economies declined slightly to 22.1 per cent of GDP influenced by robust spending in the United States, the EU and, to a lesser extent, Japan. Developing countries' savings also fell marginally to 25.4 per cent of GDP, as the increase in the rate in the Middle East and Africa was offset by the decline in Asia and Latin America and the Caribbean. Developed countries' investment was up slightly, while in developing countries, investment declined marginally. Reflecting in part saving, investment and exports, the current account deficit of developing countries narrowed substantially by 63 per cent.

Capital flows to developing countries slipped by almost 9.0 per cent in 1999. Net resource flows to Latin America and the Caribbean contracted by about 30 per cent, and could not be compensated for by higher flows to Asia and Sub-Saharan Africa. The welcome increase in flows to Sub-Saharan Africa, however, was unevenly distributed, with the lion's share going to South Africa, attracted by its privatisation programmes and other reforms.

Growth in the external debt of developing countries slowed to 1.6 per cent in 1999. The carry over from declining oil prices in 1998, led to the fastest growth in debt in the Middle East and Europe (3.9 per cent). Africa's debt grew by 2.3 per cent, largely on account of higher debt accumulation in North Africa to counter the effects of sluggish oil prices early in the year. External debt in Latin America and the Caribbean was up, by only 0.5 per cent. Private debt declined in line with lower payments commitments as a result of sluggish MERCOSUR trade. The debt relief initiative for Heavily Indebted Poor Countries (HIPCs) was extended in 1999. Countries such as Bolivia, Guyana, Mali and Mozambique benefited under the programme of debt write-offs. Debt reduction in Guyana, for instance, has enabled higher social spending.

I. INTRODUCTION

After reaching a trough in 1998, world economic activity picked up in 1999, buoyed by growth in major markets, particularly the United States, and recovery in East Asia. Financial markets have stabilised, helped by the containment of speculative flows and improved investor confidence, strengthened equity prices and continued reform and restructuring. In developing countries, however, performance remained varied and unsettling in some cases. In fact, in many countries, growth remained below levels prior to the financial crisis and although average per capita income for developing countries grew by around 2 per cent, relative to 1.6 per cent in 1998, positive growth was only recorded in the Asian subregion.[1] A number of Asian countries affected by the crisis have implemented reforms and restructured their economies to recover their resilience. This has given the lie to the notion that the Asian miracle is dead. But many other developing countries continued to be buffeted by adverse commodity price shocks, low or negative growth traps, low technological capabilities and sticky levels of poverty and inequality.

Financial market conditions improved in 1999 on the heels of the somewhat anaemic environment that prevailed in 1998, when the Russian crisis and the trough of the Asian crisis affected markets. The resurgence of vibrancy in world GDP growth with subdued inflation, permitted an easing of monetary and fiscal policies in the United States, Europe, Japan and some of the Asian economies, which were recovering, thereby facilitating more relaxed financial conditions world wide and a pick up in activity. Net private capital flows to Emerging Market Economies continued to decline, however, following the dramatic slump in 1998. Notably, stock prices have rallied rather strongly, especially in the United States bolstered by investor confidence in the 'new economy' and greater than anticipated growth in productivity. Computer and information technology stocks have soared with expectations of significant future dynamism and profitability in these sectors.

Caribbean countries registered mixed growth performance, affected in different ways by the recovery in other regions. Countries, such as Trinidad and Tobago and Belize, that benefited from favourable world demand and stronger oil prices, in the case of the former, and fisheries and other exports, for the latter, recorded creditable growth. Meanwhile others, such as Jamaica that is still recovering from the worst effects of financial sector collapse and weak sector productivity, continue to be stagnant. Indications are that the limited exposure of most Caribbean countries to speculative capital flows meant that they were largely shielded from the effects of the Asian financial crisis. However, in Jamaica underlying weaknesses in the financial system, including a mismatch of funding, over-extension of financial institutions in unprofitable real estate investment and escalating interest rates that increased loan defaults, were aggravated by the Asian crisis. The lesson which could be drawn from the Jamaica experience is that financial liberalisation must be carefully underpinned by adequate financial sector supervision, regulation and safeguards. Capital account liberalisation, in particular, must be supported by better market information and risk management strategies, including the accumulation of suitable reserves. Encouragingly, Jamaica is now undertaking further restructuring in its financial sector, including consolidation of financial institutions and strengthened accounting and regulatory architecture to redeem its financial system. In 1999, for example, four commercial banks and affiliates were merged to improve profitability prospects. But improved standards are required

[1] See, "World Economic Outlook, 2000, IMF".

to prevent not only the collapse of these services, but for averting negative spillover to the domestic financial sector.

The microeconomic, macroeconomic and structural policy demands for the Caribbean remain basically the same as before the crisis period. The overwhelming challenge relates to how to achieve balance between economic reform and restructuring to create dynamic and competitive production and trading systems and, at the same time, not compromise employment and social equity. This is understandably a delicate trade-off that relates to the extent of the possible consumption squeeze, unemployment and other intermediate adjustments that the countries are prepared to undergo in order to develop a sound macroeconomy and a competitive production apparatus. Macroeconomic stability must be based on contained and prudent fiscal policy, the control of inflation and a competitive and sustainable exchange rate. Improvements in competitiveness would entail the restructuring of firms, the implementation of competition policy and increases in productivity gains, which could create unemployment in some sectors. However, the restructuring process could lead to the creation of new productive activities, which could absorb workers leaving declining sectors, through proper systems of retraining and a flexible labour market.

For Caribbean countries, the renewed focus on growth, inequality, poverty and the ability of developing countries to catch up with the developed world is of tremendous significance. Growth with equity is something the region has long grappled with, for the most part with limited success. In fact, even in periods of fairly decent growth in the region, there has been a manifest gap between this growth and income distribution. Issues related to the offshore financial sector need increased attention especially in light of the publication of the Organization for Economic Cooperation and Development (OECD) report on Harmful Tax Competition. Policy measures have already been taken in some countries to improve the regulations and suspension of this sector, but more needs to be done to put the integrity and credibility of the sector beyond any doubt.

Another challenging issue for the region is the sustained decline in non-oil commodity prices. The adverse effect on export receipts has limited the potential contribution of exports to growth and economic welfare. The decline in commodity prices points to the need for adjustment policies, including diversification, to reduce dependence on these products and improve value added in production.

In the area of trade, the extension of preferential access to the United States market under the CBTPA in May 2000 was significant. The new agreement is basically an extension of the Caribbean Basin Initiative (CBI), to provide preferential treatment for a number of products that were excluded under the former pact. These products include textile and apparel, footwear, handbags and luggage, canned tuna and petroleum products. The prospective benefit to the region stems from the fact that these are products that some countries already are producing or are likely to produce competitively in the future. Generally, the new arrangement provides treatment for the Caribbean that is similar to what is provided to Mexico under the North American Free Trade Agreement (NAFTA). There are indications that the implementation of NAFTA in 1994 led to a significant loss of market share for Caribbean textile producers on the United States market. The CBTPA should redress the balance in preferential access to the

United States market which should lead to firmer growth in exports to the United States. However, the eligibility criteria, including commitment to WTO obligations, protection of intellectual property rights and adherence to internationally accepted covenants on workers rights may become obstacles for some countries to access the new benefits.

Also, in June 2000 the successor to the Lome IV Agreement, the ACP-EU Partnership Agreement, was signed in Cotonou, Benin. The Agreement is much more progressive and pragmatic than the Lomé protocols and seeks to correct the intrinsic weaknesses in the protocols. Reflecting the new spirit, the agreement incorporates a full political dimension, participation of civil society and other stakeholders, a central objective of poverty reduction, new and more forward-looking trade and economic cooperation and a restructured and more flexible financial protocol. Although in keeping with new global realities, the preferential protocols are likely to be eroded over time with adverse effects for exports of bananas, sugar and rum, the agreement provides scope for other exports, especially manufactured goods. Entrepreneurs would need to take advantage of technical and financial assistance provided under the Centre for Development of Enterprise - provided in the agreement to develop competitive manufactured exports. A limitation of the agreement is the limited finance provided for the private sector, which seems not to be in keeping with the espoused promotion of private sector-led growth, but which holds opportunities to be taken advantage of through creative use.

II. GLOBAL OUTPUT, INFLATION AND REGIONAL PERFORMANCE

Although the effects of the Asian crisis continued to be felt in a number of countries, global economic and financial conditions have improved considerably during 1999. The United States economy entered its eighth consecutive year of expansion - driven essentially by innovation and technology. The crisis-afflicted economies of South East Asia appeared to have staged a strong economic recovery. Economic recovery, albeit tentative and fragile, has also begun in the Countries in Transition. Buffeted by adverse international economic conditions and, more particularly, continued deterioration in non-fuel commodity prices, Latin America experienced virtual economic stagnation. The pace of economic recovery slowed somewhat in Sub-Saharan Africa, with GDP growth declining to below 3 per cent for the first time in five years.

After registering a growth rate of 2.5 per cent in 1998, **world output** rebounded significantly to record growth of 3.3 per cent in 1999. The recovery in Asia from the ravages of the financial crisis coupled with the continued robust growth of the United States economy contributed to global output expansion in 1999. In addition, the recovery of oil prices from the exceptionally low levels of 1998 and early 1999 helped to fuel economic expansion in a number of oil producing countries.

The **advanced economies** grew by 3.1 per cent, considerably higher than the 2.4 per cent growth rate recorded in 1998. Among this group of countries, the Japanese economy improved, growing by 0.3 per cent. Although this growth rate lagged behind that of the United States and the European Union, the turnaround was remarkable when compared to a contraction of 2.5 percent in the preceding year. Although GDP growth declined marginally by 0.1 percentage points in the United States, it nonetheless recorded the strongest growth (4.2 per cent) of all the advanced economies in 1999. In the wider Euro-area, output growth slowed to 2.3 per cent compared to 2.8 per cent in 1998.

In the **developing countries,** year-on-year output grew slightly from 3.2 per cent in 1998 to 3.8 per cent in 1999. The decline in output growth in Africa, the Middle East and Europe and Latin America and the Caribbean were more than offset by the increase of 6.0 per cent in Asia. In the Asian-4 countries[2] output growth rebounded significantly to 2.5 per cent after contracting by a whopping 9.5 per cent in 1998. In the **Countries in Transition** GDP recorded a growth rate of 2.4 per cent, significantly higher than the negative growth rate of 0.7 per cent in 1998.

Despite the marginal decline of output growth, the **United States** economy is now on a record expansion, driven fundamentally by strong growth in domestic aggregate demand. Inflationary forces remained quiescent, and this allowed the Federal Reserve to maintain an accommodating monetary policy stance that has boosted domestic aggregate demand and promoted easy financial conditions world wide. A major factor contributing to the robust growth of the United States economy has been the high level of investment in the information technology, the backbone of the "new economy". Expectations about the high growth potentials of this sector have attracted massive capital inflows and thereby contributed to the creation of more high tech-companies and their high valuation in the stock market.

Table 1: GDP growth rates

	1995	1996	1997	1998	1999
Global Output	**3.6**	**4**	**4.1**	**2.5**	**3.3**
Advanced economies	**2.5**	**2.7**	**3**	**2.4**	**3.1**
Japan	0.9	3.6	1.4	-2.5	0.3
United States of America	2	2.4	3.9	4.3	4.2
European area	2.5	1.7	2.6	2.8	2.3
Developing Countries	**5.9**	**6.4**	**5.9**	**3.2**	**3.8**
Africa	2.9	5.3	3.4	3.1	2.3
Asia	8.9	8.1	6.8	3.8	6
ASEAN-4	....	7.1	3.7	-9.5	2.5
China	....	9.6	8.8	7.8	7.1
Middle East and Europe	3.5	4.6	4.1	2.7	0.7
Western Hemisphere	0.2	3.5	5.3	2.1	0.1
Countries in Transition	**-1.3**	**0.1**	**1.9**	**-0.7**	**2.4**
Central & Eastern Europe	1.3	1.5	2.4	1.8	1.4
Russia	....	-5	0.9	-4.5	3.2
Transcaucasus, & Central Asia	....	1.6	2.1	2.3	4.4

Source: I.M.F. World Economic Outlook, April 2000

[2] The Asian-4 countries are Indonesia, Malaysia, Philippines and Thailand.

The benefits of this record-breaking economic expansion have reached many Americans as evidenced by the continuing tightening of the labour market. More than 2.7 million non-agricultural jobs were created, which resulted in a drop in the unemployment rate to 4.2 per cent in 1999, the lowest it has been since the 1960s.[3] The rapid growth in productivity has also made it possible to raise real (inflation-adjusted) wages, while at the same time providing a lid against inflation.

The rapid growth in domestic aggregate demand, which has been outstripping supply, has resulted in widening external disequilibrium. The current account deficits reached US$400 billion or 3.7 per cent of GDP up from US$ 150 billion in 1998. It is possible that the buoyancy of the stock market, especially the rapid increase in asset price valuations that has underpinned domestic private demand might expose the United States economy to a significant degree of vulnerability, if there is a sudden reversal in asset prices. This underscores the need to maintain prudent macroeconomic policies, both fiscal and monetary policy, to avoid any abrupt hard landing of the economy.

After contracting by 2.5 per cent in 1998, the **Japanese** economy recovered some of the lost momentum and registered a growth rate of 0.3 per cent in real GDP, underpinned by an increase in government expenditure. This macroeconomic activism boosted business confidence, which in turn led to significant improvements in corporate profitability and an increase in industrial production. Domestic demand continues to rely heavily on fiscal stimulus. Increasing levels of fiscal deficits at 5.4 per cent coupled with a government debt of 125.0 per cent of GDP imposed a limit on the continued use of fiscal policy to jump-start the economy. Deflationary pressures, which have been a perennial problem in the Japanese economy in recent years, seem to have eased considerably.

In the **European Union**, GDP growth slowed to 2.3 per cent in 1999 compared to 2.8 per cent for 1998. Economic performance masked significant divergence among individual countries in the European Area. Among the three largest economies in the EU, output growth was strong in France, which recorded a growth rate of 2.7 per cent, still below the level for 1998. Italy and Germany recorded annual growth rates of 1.4 percent and 1.5 per cent, respectively. The proposed cut in personal income tax in Germany - equivalent to ½ per cent of GDP - is expected to boost aggregate demand. In the United Kingdom, economic growth expanded by 2 per cent in 1999, slightly below the 2.2 per cent recorded for 1998. This is the longest economic expansion in the United Kingdom on record. Strong turnaround in global economic activity, coupled with a highly competitive exchange rate, could be the key to future recovery in this region.[4] Monetary policy remained accommodating so as to shore up the euro. Unemployment, which has been a major problem in the European Union countries, has now fallen further to 8.9 per cent in 1999 from 9.7 per cent in 1998, with a resultant boost in consumer and business confidence. Net job creation in 1999 went up by 1.0 per cent, owing to labour market reforms implemented in a number of countries.[5] The initiatives taken by countries to enhance the working skills and employability of the labour force and promoting the use of more flexible forms of employment for low skilled workers contributed to improved labour market conditions. Despite the tightening of labour markets and increased incomes, consumer price inflation in the European Union fell to 1.2 per cent on average. Some countries registered inflation rates of around 0.5 per cent in 1999, raising concerns about the risk of deflation.

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[3] See United States Government, *Economic Report of the President*, February 2000, Washington, DC.

[4] See I.M.F. World Economic Outlook (2000).

[5] See for example European Union, The EU Economy: 1999 Review.

Table 2: Inflation and interest rates

	1995	1996	1997	1998	1999
Inflation <1>					
Advanced economies	**2.5**	**2.4**	**2.2**	**1.5**	1.4
European Union	2.9	2.5	1.9	1.4	1.4
Japan	-0.1	0.1	1.7	0.6	-0.3
U.S.A.	2.8	2.9	2.4	1.6	2.2
Developing Countries	**22.7**	**13.3**	**9**	**10.1**	6.5
Africa	32.9	25.2	14.1	9.2	11
Asia	11.9	6.8	4.1	7.6	2.5
Middle East and Europe	35.7	24.7	22.3	26	20.3
Latin America	25.9	18.4	10.5	10.3	9.6
Countries in Transition				**22**	**44**
Central & Eastern Europe	75.3	32.4	38.9	21	21
Russia	190.1	47.8	15.8	28	86
Transcaucasus and Central Asia	250.4	65.3	36.1	13	15
Short-term interest rates <2>					
U.S.A.	5.5	5	5.1	4.8	4.8
Japan	1	0.3	0.3	0.2	0.1
Euro area	6.1	4.6	4.1	3.9	3

Notes: for the USA three months Treasury Bills, for Japan three-months certificate of deposits
Source: I.M.F. World Economic Outlook, April 2000

Table 3: Unemployment rates

	1995	1996	1997	1998	1999
Advanced economies	**7.3**	**7.3**	**6.8**	**6.7**	**6.4**
European Union	11.2	11.4	10.4	9.7	8.9
France	11.6	12.4	12.6	11.7	11
Germany	9.4	10.3	9.9	9.4	9
Japan	3.1	3.3	3.4	4.1	4.7
United Kingdom	8.2	7.5	5.7	4.7	4.4
United States	5.6	5.4	4.9	4.5	4.2

Source: I.M.F. World Economic Outlook (Interim Assessment September 1999)

Output for the **developing countries** as a whole grew modestly by 3.8 per cent after declining for two consecutive years. Performance varied considerably across regions and among countries. Non-fuel commodity exporting countries, mostly in Latin America and Africa, were severely affected by low commodity prices, whilst the fuel exporters benefited from the recovery in oil prices. The most notable among these were countries in the Middle East and a few countries in sub-Saharan Africa.

Economic performance in **sub-Saharan Africa** in 1999 underscored the vulnerability of the region's output to exogenous factors. Economic recovery still remains fragile and narrow-based. A number of factors ranging from war, weather-related factors, such as drought and floods (mainly in Southern Africa), all combined to slow down the pace of economic recovery. GDP growth stood at 2.3 per cent in 1999 compared to a growth rate of 3.1 per cent in the previous year. However, this average growth rate masked significant variations in performance across the Continent. Despite the increase in the prices of oil in 1999, Africa's two largest oil producing countries, Algeria and Nigeria, recorded reduced output growth during the year under review. Algeria's real GDP growth rate declined from 5.1 per cent in 1998 to 3.4 per cent in 1999, while in Nigeria GDP registered a growth rate of 1.1 per cent down from 1.9 per cent in 1998. In Kenya, economic growth declined from 2.1 per cent to 1.8 per cent on account of poor rainfall, which affected agricultural production. Uganda recorded the highest growth rate in 1999: 7.8 per cent compared to 5.4 per cent in 1998, underpinned by successful implementation of a macroeconomic stabilisation and structural adjustment programme. Not surprisingly, output growth contracted in the Democratic Republic of the Congo by 15.0 per cent, Sierra Leone by 8.1 per cent and the Republic of Congo by 1.6 per cent.[6]

The pace of economic recovery in **Asia-Pacific** increased beyond expectations. After declining considerably to 3.8 per cent in 1998, output growth rebounded significantly and recorded an increase of 6.0 per cent in 1999. Performance varied across countries. Most of the crisis-affected economies seem to be recovering from the financial crisis of 1997-98. GDP growth grew by 10½ per cent in Korea, 5½ per cent in Malaysia, 4.3 per cent in Thailand and to 3-4 per cent in 1999. Fiscal stimulus introduced in a number of countries coupled with policies implemented, such as real devaluation, helped underpin economic recovery in these countries. Real devaluation helped enhance export competitiveness of these countries, resulting in surpluses on the current account of the balance of payments - and the rebuilding of the once depleted foreign exchange reserves.[7] Increased foreign exchange earnings made it possible for the countries to finance more imports with the resultant increase in import volumes by 30 per cent and 25 per cent in Korea and Thailand, respectively.

A number of crisis-affected countries have implemented far-reaching adjustment and stabilisation measures to correct the structural problems that contributed to the 1997 financial crisis. Among these countries, Korea has implemented the most far-reaching and ambitious restructuring programme. The restructuring of the financial and corporate sector has progressed successfully and is reflected in declining debt to equity ratios. While the "chaebol" have made significant progress in reducing their external liabilities, more still needs to be done to strengthen their management systems. Other countries, such as Thailand, face a difficult task of economic restructuring, particularly banks' restructuring.

In China, GDP grew by 7.0 per cent in 1999 compared to 7.8 per cent in the previous year. Had it not been for the recovery that is underway in other Asian countries the Chinese economy might have grown much more slowly. This recovery together with the fiscal stimulus package

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[6] This clearly attests to the profound negative impact of political conflict and particularly civil war on economic growth in sub-Saharan Africa.

[7] In Korea, for example, gross foreign exchange reserves grew from US$9 billion in 1997 to US$83 billion at the end of March 2000.

introduced in 1999 helped offset the effect of a decline in domestic private demand on the economy. The Government continued to pursue broader financial sector reform, including interest rates liberalisation. China is expected to join the WTO in the near future and this is expected to put pressure on that country to press ahead with structural reform.

The effects of the Asian crisis continued to be felt in many **Latin America and Caribbean** countries as reflected in slower economic growth rates, reduced capital inflows and declining prices for non-fuel commodities.[8] Real growth in GDP slowed further to 0.1 per cent in 1999 compared to 2.1 per cent in 1998. Marked differences were discerned in economic performance across countries within the subregions. Mexico, Central American and some Caribbean countries recorded better economic performance than the Southern cone countries. The former group of countries (due to their strong trade and financial ties with the United States) benefited from the booming United States economy, while the latter group of countries was more affected by the sharp decline in intra-MERCOSUR trade. Mexico and the Central American country of Costa Rica recorded GDP growth rate of 3.5 per cent and 7.5 per cent, respectively. These higher growth rates were made possible by expanding exports as reflected in an increase of 16.0 per cent and 19.9 per cent in the value of exports of Mexico and Costa Rica, respectively. The two largest economies in the Southern Cone, Brazil and Argentina, recorded GDP growth rates of 0.5 per cent and –3.5 per cent, respectively, due to weak export performance. The value of exports of goods and services in 1995 prices fell by 12.6 per cent in Argentina, 7.5 per cent in Brazil, a whopping 29.4 per cent in Paraguay and by 12.4 per cent in Uruguay. There was also a noticeable decline in the value of imports in a number of countries as a result of dwindling export earnings. The region's imports (in value terms) contracted by 4.1 per cent, slightly lower than exports, which contracted by 5.2 per cent. The combined effect of declining rate of growth in exports and imports was an improvement in the current account of the balance of payments[9].

Stabilisation policies, which have been implemented in the region had contributed to price stability in Latin America which has been prone to high levels of inflation. Among the best performers, Chile stood out with an inflation rate of 2.6 per cent and Peru 4.8 per cent in 1999. However, inflation inertia still remains a real problem for a number of countries, such as Venezuela and Mexico, which recorded double-digit inflation rates of 13.9 per cent and 20.2 per cent, respectively. More needs to be done to reduce inflation rates further in these countries. While there was a downward movement in consumer prices across the region, the fiscal deficit widened further to 3.2 per cent of the product in 1999 compared to 2.7 per cent in 1998. Virtually all the countries recorded fiscal deficits ranging from 1.3 per cent of GDP in Mexico to 9 per cent in Brazil (See Figure 4). This worsening in fiscal balances was attributed to recessionary conditions and slowdown in international trade, which depressed tax revenue.

[8] See ECLAC, Preliminary Overview of the Economies of Latin America and the Caribbean, 1999.

[9] According to ECLAC (1999), current account deficit as a percentage of GDP declined from 4.5 per cent in 1998 to 3.2 per cent in 1999.

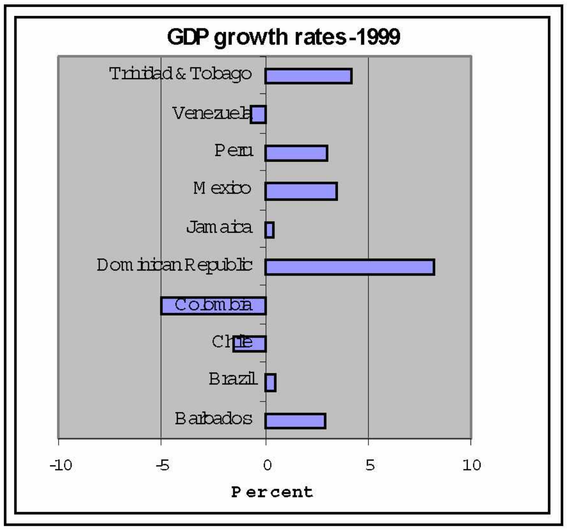

Figure 1

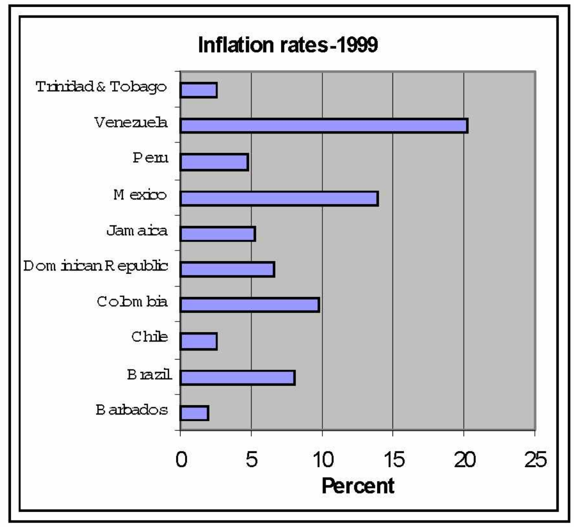

Figure 2

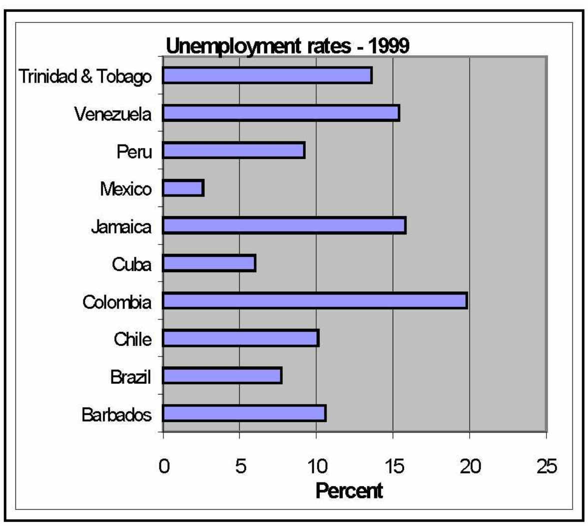

Figure 3

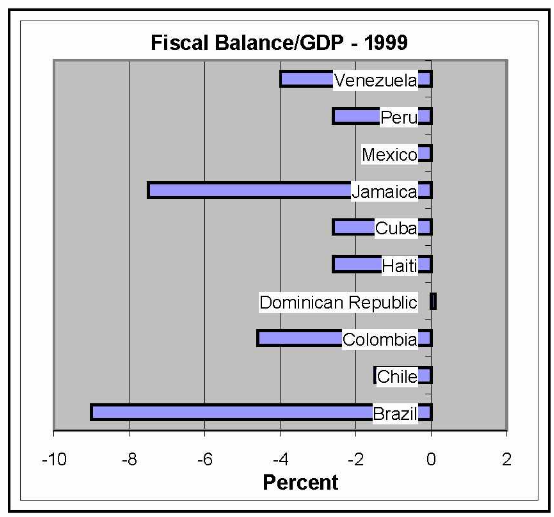

Figure 4

Source: Data from ECLAC, Preliminary Overview of the Economies of Latin America and The Caribbean, 1999 and World Bank, Caribbean Economic Overview, June 2000.

Since the United States is the largest trading partner of the **Caribbean**, the robust growth of that economy continued to provide a stimulus to sustained output growth in the subregion. The rate of growth in GDP in the Caribbean subregion rose to 3.1 per cent in 1999 compared to a growth rate of 1.8 per cent in 1998.[10] Countries that were able to take advantage of the booming United States economy by exporting more to that market recorded robust growth rates. Notable among these were the service-based economies of The Bahamas (5.8 per cent); Belize (6.2 per cent); the Dominican Republic (8.2 per cent); and the petroleum-based economy of Trinidad and Tobago (4.2 per cent). Growth was more lethargic in Suriname, Dominica and Jamaica. Not surprisingly, since Jamaica's economy relies heavily on the production of alumina for foreign exchange earnings, its exports may have been adversely affected by the explosion last July at the Kaiser's Gramercy Alumina Refinery in Louisiana, United States. As a result, its exports to the United States contracted by 10.1 per cent. Jamaica's total merchandise exports (in value terms) also fell by 10.3 per cent in 1999 compared to 5.1 per cent in 1998. Similarly, merchandise imports recorded a negative growth rate of -4.5 per cent.[11]

Economic developments and divergences in the EU, the second largest trading partner of the Caribbean, have had different implications for the Caribbean. Although Caribbean countries' exports to the EU enjoy preferential duty free access under the Lomé Convention, the continued uncertainties surrounding the EU banana and sugar preferential trading arrangement, as a result of the recent WTO ruling against the EU banana import regime, appeared to be having a negative impact on agricultural production in the Caribbean. For the OECS group of countries, as a whole, available data point to some weakening in economic performance in 1999. According to the Eastern Caribbean Central Bank (ECCB) banana output contracted in all banana producing countries, with the exception of Grenada. It fell by 11.0 per cent in Saint Lucia, 7.4 in Saint Vincent and the Grenadines and 3.0 per cent in Dominica. In aggregate, banana production for the region stood at 130,940 tons, 7.7 percentage points below the level for 1998.[12] This decline was in part attributable to unfavourable weather conditions. Similarly, output of sugarcane and cacao contracted by 21.4 per cent and 31.4 per cent, respectively. Although banana output fell by a substantial margin, earnings fell slightly by 4.0 per cent due to 0.2 percentage points increase in the average green market price per ton.

In Trinidad and Tobago, the economy grew by 4.2 per cent, underpinned by strong recovery in oil prices from the exceptionally low levels in 1998.[13] This, together with the recovery of the manufacturing sector, more than offset the negative impact of the lacklustre agricultural performance on GDP growth. In addition, the entry into production of a large refinery as well as the coming into operation of a liquefied gas plant all had positive spill-over effects on the domestic economy.

Economic reforms which have been widely implemented in the Caribbean subregion and which invariably included macroeconomic stabilization had contributed to stable prices as evidenced by low inflation rates. In 1999, consumer prices declined in line with that of the region's major trading partners – the United States and the European Union. In Trinidad and Tobago, for example, the inflation rate declined from 5.6 per cent to 2.6 per cent in 1999 while it increased slightly from 1.7 per cent in 1998 to 2 per cent in 1999 in Barbados (See Figure 2).

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[10] See ECLAC, *Preliminary Overview of the Economy of Latin America and the Caribbean, 1999.*

[11] See The Economist Intelligence Unit (E.I.U) Country Report, 1st quarter 2000.

[12] See ECCB, *Economic and Financial Review,* Vol. 18 No.4, December 1999.

[13] According to the I.M.F.'s World Economic Outlook oil prices have increased by more than x percent in 1999.

Similar to the trends observed in Latin America, the public sector deficit widened in a number of countries. Jamaica's fiscal deficit of 7.5 per cent of GDP was the highest in the subregion. The Government, therefore, introduced a series of tax measures to reduce the deficit. These include increases in special consumption tax on certain petroleum products, higher taxes on cigarettes and alcoholic beverages (+33.3 per cent) and higher motor vehicle license charges. The fiscal deficit also widened slightly in Haiti from 2.4 per cent to 2.6 per cent of GDP in 1999. The Dominican Republic, however, was the only exception as it managed to balance its budget in 1999 (See Figure 4).

III. WORLD TRADE DEVELOPMENTS

Having contracted by 1.6 per cent in 1998, the rate of growth in the world's merchandise exports (in value terms) picked up considerably - by 3.5 per cent - in 1999. Underpinning this robust growth in merchandise exports in 1999 was the recovery in Asia, particularly in the crisis-afflicted countries and continued buoyant demand in North America. Continuing the trend started in 1990, but which was disrupted in 1998, developing countries' merchandise exports grew faster than the global average. Oil exporters and exporters of manufactured goods experienced an increase in the value of their merchandise exports. Primary commodity exporters, however, recorded lower export values due to a decline in commodity prices. As in 1998, marked variations were observed in trade trends across regions and within subregions.

After contracting considerably, by 15.5 per cent, in 1998, **Africa's** merchandise exports registered a growth rate of 8.0 per cent, the second highest in the world after the Asian-4 countries. The exports of major fuel-producing African countries[14] grew substantially, by 24.0 per cent, after stagnating by 31.4 per cent in 1998. On the other hand, the rate of growth in merchandise imports slowed down to 0.5 per cent - compared to 1.2 per cent the previous year. Consequently, the faster growth in exports relative to imports led to considerable improvements in the trade balance.

Latin America recorded a 6 per cent growth in the value of merchandise exports in 1999, a considerable improvement over the contraction of –1.2 per cent experienced in 1998. However, this aggregate figure is somewhat misleading. If Mexico is excluded from the group, the positive growth rate drops to -2.0 per cent. A number of factors contributed to the differences in export performance between Mexico and the South American countries. Mexico's exports, which are made up of manufactured goods, benefited from more stable prices whilst South American countries were affected by the decline in primary commodity prices. In addition, the differences in the direction of trade contributed to the differences in trade performance. Mexico's strong trade and financial ties with the booming United States economy provided an impetus for increased exports while the stronger intraregional nature of South America's trade affected their exports due to a decline in intra-MERCOSUR trade. Merchandise imports for the region, as a whole, contracted by 4 per cent as the contraction in imports of South American countries more than offset the 13.5 per cent growth in Mexican imports.

[14] This comprises the following countries: Angola, Algeria, Congo, Gabon, Libyan Arab Yamahiriya and Nigeria.

The most salient development in **Asia's** trade in 1999 was the strong growth rate in the value of merchandise exports of the five countries[15] most affected by the financial crisis of 1997-98. Their rate of growth in exports (in value terms) rose to 9.5 per cent in 1999, from –3.5 per cent in 1998. Underpinning this strong growth was the recovery of the electronic goods industry which, for example, accounted for more than 80 per cent of the exports of Malaysia and South Korea.

Although economic growth recovered by 2.0 per cent in the **transition economies**, this however did not provide an impetus for sustained export growth. The growth rates of both merchandise exports and imports fell by 1.5 per cent and 13 per cent, respectively. The contraction in the value of trade was more pronounced in the Russian Federation where import demand contracted precipitously by some 30.5 per cent. The slow GDP growth in Europe coupled with the decline in Russian imports contributed to a lacklustre trade performance in this group of countries.

Table 4. Value of merchandise trade

	EXPORTS (f.o.b.)				IMPORTS (c.i.f.)		
	1997	1998	1999		1997	1998	1999
Global	3.5	-1.6	3.5		3.5	-0.8	4
North America	9.2	-0.7	4		10.3	4.4	11.5
Latin America	10.2	-1.2	6		18.5	4.8	-4
Mexico	15	6.4	16.5		22.6	13.9	13.5
Other	7.2	-6.2	-2		16.4	-0.1	-14.5
Western Europe	-0.6	3.4	-0.5		-0.3	5.9	0.5
European Union	-0.5	3.8	-0.5		-0.5	6.3	1
Economies in Transition	4.1	-4.6	-1.5		6.5	-1.8	-13
Central/Eastern Europe	6.3	9.5	0		5.6	10.8	-2
Russian Federation	-0.4	-15.9	0		6.7	-19.8	-30.5
Africa	1.9	-15.5	8		5.5	1.2	0.5
South Africa	6.2	-9	1.5		9.5	-9.3	-8.5
Major fuel exporters [a]	-0.1	-31.4	24		9.6	-0.8	5.5
Middle East	4.7	-22.4	22		8.1	-3.2	4
Asia	5.4	-6.1	7.5		0.4	-17.8	10.5
Japan	2.4	-7.8	8		-3	-17.2	11
China	21	0.6	6		2.5	-1.5	18
Asia (5) [b]	5.1	-3.5	9.5		-3.1	-30.9	15.5

Source: World Trade Organization
a Angola, Algeria, Congo, Gabon, Libyan Arab Yamahiriya and Nigeria
b Indonesia, the Republic of Korea, Malaysia, Philippines and Thailand

[15] This refers to the Asian-4 countries comprising Indonesia; Malaysia; Korea Republic; Thailand, plus the Philippines.

Tourism

Since the tourism sector is a major source of growth for many Caribbean countries and one of the world's largest and fastest growing industries, accounting for more than one third of the total value of services trade, it is important to examine the latest developments in this sector.[16] Global tourism grew faster (4.1 per cent) in 1999 than (3.1 per cent) in 1998. The slower growth in 1998 could be attributed to the contraction of output in many East Asian economies as a result of the financial crisis. In 1998, international tourism contracted by 0.9 per cent in the South East Asian countries. The resurgence in the economy in 1999 provided a boost to Asian tourism as reflected in the growth rate of 10.5 per cent, the second highest after the Middle East. In terms of receipts from international tourism the United States was by the far the largest earner at US$74.4 million, followed by Spain and France at US$32.9 million and US$31.7 million, respectively.[17] Earnings from tourism went up by 4.3 per cent in the United States despite a stronger US dollar.

Table 5: International tourist arrivals (millions)

	1997	1998	1999	change (%) 1998	1999
World	**618.3**	**636.7**	**662.9**	**3**	**4.1**
Africa	23.2	25	27.3	7.4	9.1
Americas	116.6	120	123	2.9	2.5
East Asia and the Pacific	88.3	87.4	96.6	-0.9	10.5
Europe	371.2	383.8	392.5	3.4	2.3
Middle East	14.3	15.3	17.9	7.2	17.4
South Asia	4.8	5.2	5.7	8	8.3

Source: World Tourism Organization (WTO) Database, May 2000

In an effort to adjust to a rapidly and ever changing international environment and diversify their economies, the Caribbean countries have developed dynamic and vibrant service economies, with tourism and financial services being the dominant foreign exchange earners. The tourism sector has assumed a leading role in the economies of many Caribbean countries and, more particularly, the OECS countries. As can be seen from Table 6, revenue from tourism amounted to EC$2,247 millions in 1999, an increase of 6 per cent over 1998, despite the 2.6 per cent decline in total visitor arrivals. Cruise ship passengers contracted by 5.8 per cent, while stay-over arrivals increased by 3.7 per cent. This more than offset the contractionary impact of cruise ship passengers on total receipts, due to the greater influence of stay-over arrivals on the overall performance of the industry. A breakdown of stay-over arrivals by country of origin reveals a strong growth (16.4 per cent) in visitors from the

[16] See World Trade Organization, Tourism Services, S/C/W/51, 23 September 1998.

[17] See World Tourism Organization at http://www.world-tourism.org " World Tourism results Revised upwards.

United Kingdom compared to a meagre 1.2 per cent for the United States. Stay-over arrivals from Canada contracted substantially by 11.2 per cent.

Table 6: Selected tourism statistics - ECCB area

	1998	1999	% Change
Total Visitor Arrivals	2,441,767	2,377,696	-2.6
Stay-Over Arrivals	838,195	869,031	3.7
USA	275,013	278,209	1.2
Canada	50,860	45,140	-11.2
UK	175,444	204,182	16.4
Caribbean	211,363	213,329	0.9
Other Countries	125,515	128,171	2.1
Excursionists	111,447	102,560	-8.0
Cruise Ship Passengers [a]	1,492,125	1,406,105	-5.8
Number of Cruise Ship Calls[b]	1,505	1,514	0.6
Total Visitor Expenditure (EC$)	2,129.39	2,257.66	6.0

Source: Eastern Caribbean Central Bank, Economic and Financial Review, December 1998 and December 1999

[a] Excludes Anguilla but includes yacht passengers for St Kitts and Nevis and St Vincent and the Grenadines.
[b] Excludes Anguilla and St. Vincent and the Grenadines.

Complementing tourism services have been trade in financial services, which has increased rapidly in recent years largely in response to rapid technological change, and financial liberalisation policies. Offshore financial centres have flourished in many countries and more particularly in the English-speaking countries, providing a wide range of financial services. These have fostered economic growth, generated employment and increased the availability of finance for development. However, many fear that the 1998 OECD Report *on "Harmful Tax Competition: An Emerging Global Issue"*[18] may negatively affect the further evolution and development of the offshore financial industries world wide, and more particularly in the Caribbean.

[18] The following Caribbean countries were identified in the report to have harmful tax regimes: Anguilla; Antigua and Barbuda; Aruba; The Bahamas; Barbados; Belize; British Virgin Island; Dominica; Grenada; Montserrat; Netherlands Antilles; St. Lucia; St. Kitts and Nevis; St. Vincent and the Grenadines; and US Virgin Islands.

IV. INSTITUTIONAL DEVELOPMENTS IN THE AREA OF TRADE

The evolution of the global trading system is being accompanied by an explosion in regional trading arrangements around the world. Unlike the earlier waves of regionalism, the current wave seems to be facilitating rather than impeding the integration of countries into the multilateral trading system as embodied in the **WTO**. The salient activity that preoccupied the organization in 1999 was the preparation of the WTO Third Ministerial Meeting in Seattle, Washington. The Seattle Meeting was intended to set the agenda for the Millennium Round of trade liberalisation negotiations as well as to discuss further liberalisation in agriculture and services, which remain unfinished on the agenda of the Uruguay Round of trade negotiations. The WTO Ministerial Meeting in Seattle failed from the beginning. Countries were markedly divided on issues to be discussed at the ministerial summit. Developing countries were eager to discuss issues pertaining to agriculture liberalisation and, more specifically, quotas on clothing and textiles, but had little interest in issues such as e-commerce, labour standards and environment and trade linkages. On the other hand, the United States wanted to discuss labour standards and possibly reach an agreement on e-commerce. These marked differences in countries' positions made it difficult for delegates to reach an agreement on an agenda for trade negotiations. In addition, the many demonstrations, particularly by labour movements and the environmentalists, contributed to the failure of the Seattle Summit.

Having launched the single currency, the euro, the **European Union** continued to work vigorously towards widening the grouping. It adopted a single framework for 13 applicant countries. It took a decision at its Helsinki Summit in December 1999 to widen the accession process to 13 applicant countries[19]. Encouraged by this decision, countries on the European Union accession track implemented a series of economic reforms, including structural adjustment measures necessary for preparing them for the EU membership. The first applicant countries are expected to be admitted towards the end of 2002.

In addition to its efforts aimed at the enlargement process and in line with its commitment to 'open regionalism', the EU concluded a series of negotiations with other countries so as to widen integration to other parts of the world. Most notably, progress was made towards finalising the long awaited post-Lome Development Partnership Agreement as a successor agreement to the Lome IV Convention when negotiations were held in 1999 with the ACP group of countries. Furthermore, EU-Latin America relations entered a new phase when the two regions reaffirmed their commitment at the summit of Heads of States or Government to develop a strategic partnership between the two regions.

Progress towards the establishment of a **Free Trade Area of the Americas** by 2005 remained on track with the convening of the Fifth Ministerial Meeting in Toronto, Canada, on 3-4 November 1999. The ministers responsible for trade, representing the 34 countries, reaffirmed their commitment to the principles and objectives set out in Miami in 1995. Similar to APEC and the EU, the FTAA is expected to embrace open regionalism with the aim of facilitating rather than impeding multilateral trade liberalization.

After trade disputes erupted between the two largest economies in the trading bloc, Brazil and Argentina, in early 1999, **MERCOSUR** countries continued to work towards deepening the

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[19] The following are the 13 applicants to the EU: Bulgaria, Cyprus, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Romania, Slovakia, Slovenia and Turkey.

integration process. Recognising the profound negative impact of the financial crisis on regional economies, the countries saw the need to coordinate macroeconomic policies so as to mitigate the vulnerability of the economies to financial contagion. At the biannual MERCOSUR summit held on 7-8 December 1999 in Montevideo, Uruguay, they reached agreement on a Southern Cone convergence criteria as well as on harmonisation of economic policy in general and fiscal and financial policy in particular.

After many of the region's economies suffered the brunt of the financial crisis in the period 1997-1998, Asia Pacific Economic Cooperation (**APEC**) countries made considerable efforts over the last two years to restructure the economies and put in place the necessary mechanisms to strengthen their supervisory and prudential regulations. The annual summit of the APEC, which was held in Auckland, New Zealand, in September 1999, reviewed progress made by the Asian countries in reforming their economies. Furthermore, the organization committed itself to air service liberalisation in the whole APEC region by:

- Eliminating restrictions on air-related services, such as ground handling and computer reservations;
- Removing barriers to airfreight service providers;
- Allowing multiple airline designation, increasing competition in domestic and international markets; and
- Allowing airlines to cooperate with each other through ventures, such as code sharing.

The liberalisation of the air service industry is expected to bring significant benefits to countries in the APEC region. According to APEC, in 1997 the region accounted for 33 of the 50 largest airlines in the world, carrying more than 789 million passengers, which generated a combined revenue of US$172 billion.

Deepening the integration process within the subregion and widening it to other areas of the Americas continued to be the overriding priority agenda for 1999 for the **Caribbean Community (CARICOM)**. To this end, the Community made concerted efforts towards finalising the establishment of the Single Market and Economy (SM&E). One such effort was the signing of protocols amending the Treaty of Chaguaramas. The following protocols were signed: Protocol IV - on trade policy; Protocol VI - on transport policy and Protocol VII - on disadvantaged countries, regions and sectors. Furthermore, in an effort aimed at widening the integration process to other areas of the Americas an agreement was signed between CARICOM and the Dominican Republic in 1999. The agreement seeks to facilitate trade and create markets for certain goods. Provisional agreements were also signed for the entry of certain products from Colombia on preferential terms. In addition, bilateral trade and investment agreements were being negotiated with Mexico and the MERCOSUR countries.

An important development for the Caribbean in 1999, and one which undoubtedly had a profound impact on the trade relations between the United States and the Caribbean, was the ongoing debate in the United States Congress on a trade bill that would give trade preferences to Sub-Saharan Africa and Caribbean Basin countries. After a protracted debate, United States legislators overwhelmingly passed the Trade and Development Act by a vote of 77-19. President Bill Clinton subsequently signed the Bill into law. By giving 25 Caribbean Basin and 48 sub-Saharan African countries trade parity with Mexico, the Act is expected to prevent further erosion of preferences conceded under the Caribbean Basin Economic Recovery Act (CBI) of 1983. It extends trade preferences to a number of products such as apparel, petroleum products, textiles, etc which, were hitherto excluded from the CBI.

V. FINANCIAL DEVELOPMENTS

1. Continuing the reforms of the global financial system

The programme of action to reform and strengthen the international financial system continued in 1999. Importantly, efforts were made to make the measures more integrated and wide-ranging in an effort to avert or limit the impact of future crises. Strong emphasis was placed on reforming and strengthening financial institutions and arrangements. Among the initiatives started was the Financial Stability Forum, which was established in April 1999 to promote international financial stability through improved cooperation and coordination in the areas of financial market supervision, surveillance and regulation. In recognition of their pivotal role in the global economy, the Forum proposed strategies for the strengthening and reform of the governance systems of the International Financial Institutions (IFIs). To enhance transparency and to promote best practices in financial markets, the Forum proposed the rapid development of internationally agreed codes of transparency and standards of best practice for both public sector and private financial institutions. In addition, calls were made for countries to provide more timely and comprehensive data on capital flows, especially short-term speculative flows. Importantly, countries were urged to make improved disclosure of their direct material exposure to Highly Leveraged Institutions (HLIs) since these institutions tended to be particularly vulnerable.

Moreover, creditors in industrialised countries were urged to make better assessments of the risks associated with financial markets in different countries. These included the implementation of the Basle Committee’s revisions to the Capital Accord and encouragement and incentives for offshore financial centres to comply with internationally accepted supervisory and regulatory standards to aid in the fight against money laundering. Also essential was the demand for countries to link macroeconomic policy reform with financial sector restructuring. This centred on strategies to help emerging economies to implement a well-sequenced approach to capital account liberalisation and to curtail their dependence on short-term capital flows. Capital account policies were to be supported by credible and sustainable exchange rate mechanisms, reflecting the reserve positions and prospects for longer-term growth. The World Bank and the International Monetary Fund (IMF) were also called upon to strengthen their cooperation with and assistance to emerging economies to make their financial systems more resilient.

The Financial Forum called for support to be provided through the IMF’s new Contingent Credit Line (CCL) for countries that were pursuing sound policies when, through no fault of their own, they were affected by financial contagion. Also, a greater role was provided for the private sector in crisis management. Notably, a pivotal role was provided for social policies to cushion the burden of adjustment that fell on the poor during crises. In addition, there was a clarion call for the international community to step up collaboration with governments to promote investment in people through health, education, and other basic needs in order to underpin sustainable development.

2. Financial adjustments and other policy issues in 1999

The broad-based resurgence in financial markets, especially in the Asian crisis economies, some of which have had v-shaped recoveries, does not mean that all is well in these markets. Indeed, the reforms and restructuring, that have facilitated some return to health, need to be maintained to avert or minimise the effects of future crises. Given the varying extent of restructuring and adjustment, the prospective long-term financial viability of different countries and regions remained quite disparate. The Asian crisis economies, notably the Republic of Korea, have made good progress in restructuring their financial and corporate sectors and have therefore seen renewed investor confidence. The restructuring of Daewoo, for instance, has provided an important positive signal of the goal of the authorities to improve transparency and accountability in traditional businesses in Korea. Further, the continued restructuring of the large industrial corporations or chaebols in Korea and the keiretsu systems in Japan should strengthen the business environment in these countries.

An important issue of concern has been the relatively wild swings in asset prices, especially in industrial and some emerging market economies. These sharp changes in the prices of stocks, land and property have often accentuated the business cycle, reinforcing booms and making recessions more intractable. Steep fluctuations in asset prices have particularly perverse effects on the balance sheets of financial institutions forcing re-valuations of non-loan assets and changes in earning fees and charges. Notably, by sharply reducing the net worth of households and corporate institutions, plummeting asset prices tend to raise significantly the ratio of non-performing loans in the total loan portfolio of financial institutions. These effects have been manifested in countries as diverse as Indonesia and Jamaica. In addition, financial fragility triggered by an initial round of asset price declines could create self-fulfilling negative expectations that could lead to a run on banks and severe credit crunches. This impinges on the availability of capital for dynamic entrepreneurs, dampens the productivity of investment and weakens sustained growth performance. To better assess their impact on inflation; asset prices must be better reflected in the basket of goods and services used for inflation targeting. Moreover, monetary policy, a more flexible instrument than fiscal policy, must be used in a timely manner to offset the impact of rapid asset price inflation or deflation on economic performance.

The debate over the cost-benefit of dollarisation was rekindled in 1999. Currencies in a number of emerging economies tumbled in the wake of the Asian financial crisis, and some have been hard-put to recover strength in the ensuing period, impinging on the resurgence in growth. Dollarisation was deemed an option for creating a credible exchange rate mechanism in countries such as Argentina and Ecuador. The debate over dollarisation was prompted largely by speculative attacks against a number of currencies and the resulting depreciation, even in the face of relatively sound macroeconomic fundamentals in some countries. Argentina continued with its currency board arrangements, but in 2000 Ecuador, after some consideration, adopted the United States dollar as its domestic currency. Contrary to the European Union economies, which are more akin to an optimal currency area because of the similarity of their economic and financial structures, Latin American countries, such as Argentina and Ecuador, are not in an optimal zone currency with the United States. This might curtail the benefits of dollarisation for these countries. Nevertheless, dollarisation should reduce the countries' risk premiums, leading to lower interest rates and thereby reducing debt servicing costs and also improving stability and restricting the impact of crises by dampening the impact of speculative attacks, since the United States dollar is a seigniorage currency. Moreover, by strengthening financial integration with the United States, dollarisation could facilitate trade and investment with the United States.

A major disadvantage of dollarisation is that it basically eliminates the adjustment mechanism provided by flexible exchange rate instrument. Dollarisation means that a country, in order to maintain its trade competitiveness, must make real devaluation changes through a decline in nominal wages and prices, or relatively slower growth in costs than in partner countries. However, given nominal wage-price inertia, competitive adjustments could prove difficult. Also, dollarised economies stand to lose seigniorage revenue from the issue of the domestic currency, as this would accrue to the United States alone, unless a sharing plan is agreed to, but this is unlikely.

Privatisation continued to provide an important avenue for curtailing the role of the State in productive activity and for restructuring and making profitable loss-making enterprises. The whole spectrum of privatisation instruments were used in 1999, including auctions, stock offers, management-employee buyouts, joint ventures, management contracts, build-own-operate (BOO) and build-own-operate-transfer (BOOT). In 1998, proceeds from direct sales represented roughly 75 per cent of privatisation revenues, while public offers accounted for most of the balance of sales. Estimates for 1999, however, indicate that the lion’s share of revenues came from divestitures in telecommunications and power, oil, and gas and banking and financial services. In addition, privatisation gained momentum in East Asia and the Pacific, boosted by the rebound in growth, but slowed in Latin America, after vibrant growth in 1998.

In Latin America and the Caribbean, proceeds from privatisation declined in 1999, from the US$38.0 billion that was raised in 1998. This resulted primarily from a decline in the privatisation programme in Brazil, where activity had been quite high in 1998. Nevertheless, this was partly compensated for by a booming programme in Argentina, where the sale of Yacimentos Petroliferos Fiscales raised over US$15.0 billion. Privatisation is expected to maintain momentum in 2000 and 2001, as countries attempt to contain their fiscal deficits and get rid of loss-making enterprises. In the Dominican Republic, for example, the long awaited privatisation of the sugar company Consejo Estatal de Azucar (CEA) was completed with the finalisation of a 30-year lease agreement with four private companies. Proceeds from this privatisation programme are estimated at more than US$11 million a year. In Guyana, the government made a bold step in finalising the privatisation of the Electricity Company. This is expected to provide the needed impetus to the domestic economy through more capital inflows to finance investment projects. Across the region, there is still further scope for divestment of utilities, telecommunication and transport and financial services, and privatisation in these areas is expected to pick up considerably in the years ahead. Privatisation in the power sector in 2000 is expected in Brazil, Argentina, and the Republica Bolivariana de Venezuela, while in the telecommunications sector programmes are planned for Colombia. An important concern with respect to the privatisation of non-tradable activities, though, is the possibility of replacing public monopolies with private monopolies or oligopolies. This could prevent the expected improvement in efficiency and benefit to the consumer in terms of cheaper and better quality products or services. In some instances, the situation is compounded by the fact that some of these private monopolies are not regulated, leaving operators wide latitude for anti-competitive practices. Fortunately, the pendulum has swung in recent times, in favour of market regulation, which does not stifle innovation and product development, especially in information technology.

3. Trends in savings and investment and current account developments

World savings remained stable at around 23.2 per cent of GDP in 1999, which was about the average for the period 1994 to 1999. In the advanced economies, savings contracted marginally to 21.8 per cent of GDP from 22.1 per cent of GDP in 1998 (See Table 7). This contrasted with a pick up in growth in these economies from 2.4 per cent in 1998 to 3.1 per cent in 1999. Savings contracted in the United States, the European Union and Japan and also in the Newly Industrialised Asian economies and developing countries.

In the **United States**, extremely robust private consumer and investment demand has led to significant private sector dis-saving. Although total savings fell by only 10 basis points to 18.7 per cent of GDP, private savings slipped a full 1 per cent to 14.7 per cent of GDP. Fuelled by vibrant asset prices (both equity and real estate), the household savings rate in the United States has actually fallen by roughly 5 per cent of disposable income since the early 1990s. By contrast, aggregate investment in the United States has increased by 20 basis points to 20.7 per cent of output, driven by robust private investment and a pick up in public investment.

Of concern for the United States is the fact that private borrowing, as a ratio of GDP, is at a record high for the post war period. This creates a cloud of doubt over the sustainability of the internal and external imbalances and United States growth ultimately. Currently, the disequilibrium has been manifested in the growing current account deficit, rather than in rising inflation. Moreover, very robust asset prices, influenced largely by stock prices, have buoyed private sector profitability, confidence and the expectations of future dynamism. In fact, in the United States, it is estimated that over 25 per cent of household wealth is held as equity holdings, while the point elasticity of consumption spending relative to stock market wealth ranges from 0.03 to 0.07[20]. This indicates that up to a maximum of 7 cents of every dollar rise in stock market wealth is spent on consumer goods. This is quite high by international standards.

There are fears that contrary to investors' expectations, a correction in stock prices could ensue in the future, since the market might be overvalued. Indeed, IMF Staff estimates indicate[21] that stock markets valuation in the United States, the United Kingdom, France and Spain appear to be above the values that are justified by the explanatory variables. If United States stock valuations are corrected rapidly (especially if technology-weighted NASDAQ stocks do not fulfil expectations) leading to plummeting prices and if efforts are made to reduce current account deficit quickly, this could lead to a 'hard landing' of the United States economy. Such a scenario would lead to a sharp reduction in consumer and investment demand and would dampen United States growth with potentially severe fallout in the world economy, as a whole. As a matter of fact, the important role that the United States economy played in helping to pull the Asian crisis economies out of recession, and generally stabilising the world economy in the aftermath of the crisis, highlights the potential negative effects of a United States hard landing.

The worse case scenario is that the United States hard landing would cut short the export momentum of the Asian, Latin American and other economies, sending the world economy into another tail-spin. In reality though, the actual turnout may be more benign than this, since some of

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[20] See Nicolas Crafts, "Globalisation and Growth in the Twentieth Century," IMF Working Paper WP/00/44, IMF 2000.

[21] See International Financial Statistics; IMF staff estimates; and BIS, 69th Annual Report.

these economies have restructured and are better placed to grow even if the United States economy weakens. For the Caribbean though, the consequences of a United States recession could be quite severe. In countries, such as Jamaica, where the financial sector recovered in 1999, and the OECS, where growth was supported by tourism receipts and offshore financial sector activity, all benefited from the trickle down from vibrant United States growth. Other countries, such as Trinidad and Tobago and Belize, have profited from the pick up in demand for exports of petrochemical products and fisheries and forestry products for Belize. Indeed, growth expanded by 6.4 per cent in Belize in 1999. Should United States growth suddenly take a nose-dive, the negative contagion effects on the Caribbean could weaken growth and employment generation, especially for economies, like Trinidad and Tobago, that have just started to make some progress in these areas.

Similar to the United States, aggregate **savings** in the **EU** declined in 1999. Total savings declined marginally by 20 basis points to 21.1 per cent of GDP. Private savings contracted by 70 basis points, but were compensated for partly by a 40 basis points increase in public savings. Significant fiscal tightening related to the Maastricht criteria for the European Monetary Union (EMU) membership dampened public sector spending, resulting in some improvement in savings. Meanwhile, robust consumer demand, which grew by about 3 per cent, impacted negatively on private savings. In contrast, total **investment** increased marginally by 40 basis points to 20.9 per cent of GDP. Capital formation was largely unaffected by the stagnation in real demand. Gross fixed capital formation rose by 4.5 per cent, about the same rate as in 1998 and capital accumulation (both in the business and real estate sectors) was bolstered by relatively low interest rates.

Total **savings** contracted in **Japan** largely as a result of the slump in public sector savings which declined by 2.5 per cent of GDP. Most of the fiscal stimulus to “pum-prime” the economy took place in the first half of the year, when robust government investment galvanised private sector demand. Unfortunately, there was some backtracking in the second half of the year and the economy contracted at an annualised rate of 4 per cent in this period. Contrary to what is needed, private savings rose by 1.2 per cent of GDP, serving to dampen the much-needed nascent recovery. Although not as bad as in 1998, Japan was still affected by 'liquidity trap effects'. Therefore, even though the Bank of Japan maintained its 'zero interest rate' policy, private demand remained anaemic. Reflecting the decline in private **investment**, total investment in Japan contracted by 60 basis points to 26.1 per cent of GDP. Public investment was constrained in the second part of the year by the large government debt overhang, which stands at about 105 per cent of GDP. Meanwhile, private investment was dampened by weak investor sentiment, occasioned by corporate and financial restructuring and uncertainty about future profit prospects.

In the **developing countries**, **savings** dipped marginally to 25.4 per cent of GDP, in spite of stronger growth in output. Among the regions, savings increased in the Middle East and Europe and in Africa, but were down in Asia and Latin America and the Caribbean. In the Middle East and Africa stronger oil prices fuelled by stronger world activity and restrictions in quotas by the Organization of Petroleum Exporting Countries (OPEC), resulted in burgeoning export receipts that contributed to reductions of the fiscal and current account gaps in some countries. South Africa benefited from firmer metal prices, which contributed to a better than expected reduction in the fiscal deficit. Moreover, fiscal consolidation in some countries and drought conditions in Algeria, the Islamic Republic of Iran and Morocco led to monetary restraint that constrained consumption and encouraged savings. Aggregate savings in the Asian developing countries, though declining since the crisis of 1997-98, remained comparatively high at 31.6 per cent of GDP in 1999. Savings were dampened in 1999 by the vibrant recovery in public consumption and investment and private consumption, notably in Korea, Malaysia and Thailand which registered GDP growth of 10.5 per cent, 5.5 per cent and 4.5 per cent, respectively.

Similar to Asia, savings have trended downwards in **Latin America and the Caribbean** since the financial crisis of 1997-98. Savings slipped by over 1 per cent of GDP in 1999, to 16.3 per cent of GDP. This was only just over half the ratio for Asia and only exceeded the figure for Africa. Like Africa, the sub-optimal level of savings in Latin America and the Caribbean remains a severe drag on sustainable GDP growth and poverty alleviation. Savings growth was constrained by the relatively sharp fall in real output and the significant domestic and external debt servicing commitments, especially in Brazil, Mexico and Venezuela. Savings in the Caribbean subregion have tended to average above the rate for Latin America, in the region of about 19 per cent of GDP in the 1990s. This is no great consolation, however, as World Bank data indicate that the world's fastest growing economies in the 1990s have had savings rates in excess of 25 per cent of GDP. Further, comparatively lower savings in Latin America and the Caribbean have been aggravated by relatively lower productivity and efficiency of investment and inadequate funding for potentially viable enterprises**.** Recent data are not available, but data from the World Bank Regional Study (1986), indicate that the incremental capital output ratios (ICORs) for high growth economies, such as the Asian Tiger economies, ranged from 2.7 to 4.0, with a mean of 3.6, while for low growth economies it was between 4.0 and 13.0, with a mean of 7.2. For a group of Caribbean countries[22] estimates ranged from 6.7 to 14.1, significantly higher than for the best performing Asian economies. Caribbean economies therefore need to design policies to enhance the productive use of savings.

Similar to saving, developing countries' **investment** spending has contracted since the Asian financial crisis. In 1999, investment declined by about 60 basis points to 25.7 per cent of GDP. Investment outlays contracted in all the major regional groupings, though the experience of individual countries varied. Investment contracted by a significant 2.5 per cent of GDP in Latin America and the Caribbean, reflecting sluggish activity. In the Asian developing countries, investment fell by over 1 per cent of GDP, in consequence of some fragility in the business environment, which led to stagnation in foreign borrowing. In **Africa**, investment remained fairly stable at around 20 per cent of real output. Investment in **Sub-Saharan Africa** was negatively affected by weak commodity prices, stagnant export demand and adverse weather conditions in Mozambique. Civil unrest in the Democratic Republic of Congo and Sierra Leone triggered capital flight and constrained investment. Some countries in the region have undertaken programmes aimed at macroeconomic stabilisation, especially fiscal reform and price stability and the restructuring of their production systems for greater competitiveness. These adjustments, as in South Africa, need to be underpinned by strengthened domestic savings and local investment to drive growth and to reduce the debt servicing constraint on future growth from large-scale foreign borrowing. Although the increase in the price of oil in the latter part of the year provided some impetus to investor confidence, investment remained largely depressed in the Middle East and North Africa.

[22] See CARICOM, Caribbean Development to the Year 2000, 1988.

TABLE: 7: Summary of sources and uses of world savings (in per cent of GDP)

	Averages							
	1978-93	1986-93	1994	1995	1996	1997	1998	1999
World								
Saving	23.3	22.8	23.1	23.2	23.3	23.9	23.2	23.2
Investment	24.4	24.0	23.8	24.2	24.0	24.1	23.3	23.2
Advanced economies								
Saving	22.0	21.0	20.9	21.4	21.5	22.2	22.1	21.8
Private	21.6	20.4	20.8	21.0	20.6	20.1	19.5	19.0
Public	0.4	0.6	..	0.4	0.9	2.0	2.7	2.9
Investment	22.8	21.8	21.3	21.5	21.6	21.8	21.6	21.8
Private	18.3	17.8	17.3	17.6	17.7	18.1	18.0	18.1
Public	4.5	4.0	4.0	4.0	3.9	3.7	3.6	3.8
United States								
Saving	19.7	16.9	16.4	17.0	17.3	18.3	18.8	18.7
Private	19.9	17.9	17.0	17.1	16.5	16.4	15.7	14.7
Public	-0.2	-1.1	-0.6	-0.1	0.8	1.9	3.1	3.9
Investment	21.2	18.9	18.8	18.7	19.1	19.8	20.5	20.7
Private	17.7	15.2	15.6	15.5	15.9	16.7	17.5	17.5
Public	3.5	3.7	3.2	3.2	3.2	3.1	3.1	3.2
European Union								
Saving	20.7	20.4	19.8	20.6	20.4	21.1	21.3	21.1
Private	20.9	21.2	22.3	22.7	22.0	21.1	20.3	19.6
Public	-0.2	-0.8	-2.6	-2.1	-1.6	..	1.0	1.5
Investment	21.5	21.2	19.7	20.0	19.4	19.7	20.5	20.9
Private	17.6	18.0	16.9	17.4	17.0	17.4	18.2	18.5
Public	3.9	3.3	2.8	2.6	2.4	2.3	2.3	2.4
Japan								
Saving	31.2	33.1	31.5	30.7	31.5	31.4	29.9	28.7
Private	27.5	24.9	26.0	25.9	27.0	26.8	26.8	28.0
Public	3.7	8.1	5.5	4.9	4.5	4.5	3.1	0.6
Investment	30.1		28.7	28.6	30.0	29.1	26.7	26.1
Private	21.3	23.4	20.0	20.0	21.2	21.3	19.1	18.1
Public	8.8	7.0	8.6	8.6	8.7	7.8	7.6	8.0
Newly industrialised Asian economies								
Saving	..	35.6	33.6	33.7	32.8	32.7	33.3	32.9
Private	..	27.9	26	26.3	25.8	25.9	25.8	25.8
Public		7.7	7.7	7.4	7	6.8	7.5	7.1
Investment	..	29.9	31.9	32.7	32.2	30.8	23.4	25.3
Private	..	23.8	25	26	25.5	24.2	16.2	18
Public	..	6.1	6.8	6.7	6.7	6.6	7.2	7.3
Developing Countries								
Saving	22.5	23.4	26.6	26.3	26.5	27.1	25.9	25.4
Investment	24	25.4	27.9	28.7	27.7	27.6	26.3	25.7
Net Lending	-1.5	-2	-1.3	-2.5	-1.2	-0.5	-0.4	-0.3
Africa								
Saving	21.2	16.1	15.5	15.2	16.6	16.4	15.8	16.2
Investment	23.2	19.3	19.7	19.5	18.5	18.5	20.4	20.3
Net Lending	-1.9	-3.2	-4.2	-4.3	-1.9	-2.1	-4.6	-4.1
Change in reserves	0.1	..	1.7	0.8	2.2	2.4	-0.3	0.5
Asia								
Saving	25.1	28.7	33.4	32	32.5	33.4	32.6	31.6
Investment	26.1	30	33.9	34.6	33.5	32.4	29.9	29.7
Net Lending	-1	-1.4	-0.4	-2.7	-1	1	2.8	1.9
Change in reserves	0.8	0.9	3.3	2.1	2.3	2	1.2	1.4
Middle East and Europe								
Saving	24.5	19.2	21.9	23.4	20.1	21.1	17.9	19.3
Investment	24.3	23.3	21.6	23.9	20.2	21.9	22.5	21.5
Net Lending	0.3	-4.1	0.3	-0.4	-0.1	-0.8	-4.6	-2.2
Change in reserves	0.8	0.3	0.9	1.7	2.6	1	-1.9	1.5
Western Hemisphere								
Saving	18.9	19.2	18.7	19.1	19.2	19.4	17.4	16.3
Investment	21.5	20.9	21.6	21.4	21.3	22.5	22	19.5
Net Lending	-2.6	-1.7	-2.9	-2.3	-2	-3.2	-4.6	-3.2
Change in reserves	0.2	0.6	-0.2	1.3	1.9	1	-0.9	-0.3

Source: IMF World Economic Outlook, April, 2000

4. Current account developments

In consequence of their varied dependence on international trade and capital flows and the differential pace of recovery after the Asian financial crisis, **current account** developments varied across countries and regions.

Buttressed by stronger export prices for oil and metals, strengthened export demand for manufactured goods and buoyant investor confidence in a number of countries, the current account of developing countries, as a whole, improved in 1999 (see Table 8). **Developing countries** current account deficit contracted sharply by an estimated 63 per cent, influenced primarily by the large current account surplus in Asia. Even with an estimated contraction of 13 per cent, the current account surplus of **Asian** developing countries remained strong at around US$42 billion. Whereas in 1998, the current account surplus in Asia was supported by import compression, in 1999, it was driven by a robust recovery in exports. Merchandise exports grew by almost 6 per cent in 1999, with especially strong growth of 9.7 per cent in the latter half of the year, boosted by world demand for semiconductors and other electronic products.

Meanwhile, although unacceptably large for some countries, the current account deficit declined in the other developing country regions. An optimistic development, which it is hoped will continue, was the reduction in the current account deficit of **Africa** by roughly 16 per cent. The merchandise trade account of a number of African countries improved, as a consequence of stronger oil and metal prices. However, a number of West African countries, including Ghana and Ivory Coast, were adversely affected by weak cotton, cocoa and coffee prices, but in some of them, import compression mitigated the negative impact on their current accounts.

Countries in the **Middle East and Europe** also recorded a substantial reduction in their current account deficit, which had ballooned to over US$30 billion in 1998. Similar to other oil exporters, countries in the Middle East benefited from significant terms of trade gains influenced particularly by the escalation in oil prices. In addition, countries in the region were also favoured by improved tourism receipts and worker remittances. In **Latin America**, the current account deficit contracted to just over US$54 billion in 1999, from almost US$90 billion in 1998, a peak for the decade. A number of countries including Mexico, Brazil, Argentina and Chile benefited from vibrant export demand with the stimulus provided by the strong growth in the United States economy. Brazil and Colombia were also favoured by strengthened export competitiveness due to real exchange rate depreciation. On the domestic side, import compression also helped the current account, but with the expected pick up in import demand in 2000, the current deficit was projected to widen. Fortunately the growth stimulus provided by the rebound in exports and narrowing of the current account deficit led to some lowering of unemployment in some countries, especially Chile and Colombia.

The **Countries in Transition** also saw a substantial decline in their current account deficit. The deficit in these countries narrowed by over 78 per cent to around US$5 billion. On the upside the countries' external position was buoyed by rising oil and metal prices, while demand restraint, especially for imports had a positive effect on the current account position.

TABLE 8: Summary of balance of payments current account for different regions (billions of US$)

	1995	1996	1997	1998	1999	2000
Advanced Economies						
United States	56.5	43.4	93.9	43.1	-133.7	-212.9
Euro Area	56.6	89.9	112.5	86.5	43.7	64.9
Japan	111.4	65.8	94.1	121	107	102.4
Other advanced economies	-0.1	10.6	14.1	54.6	69.7	56
Memorandum						
Industrial countries	55.7	48.4	86.2	-22.2	-193.2	-261.4
Newly industrialised Asian economies	5.9	0.3	11.2	66.1	61	49.8
Developing countries	-111.4	-74.2	-59.1	-89.9	-32.7	-11.6
Regional Groups						
Africa	-16.5	-7	-7.4	-20	-16.8	-7.7
Asian	-56.3	-38.7	6.8	48.9	42.3	31.7
Middle East and Europe	-1.8	9.8	5.6	-30.3	-4	20.9
Western Hemisphere	-36.8	-38.3	-64.1	-88.6	-54.2	-56.5
Analytical groups						
By source of export earnings						
Fuel	0.8	30	21.4	-34.6	3.4	45.3
Nonfuel	-112.3	-104.4	-80.7	-55.7	-36.1	-56.7
By external financial source						
Net Creditor countries	1.9	13.2	11.7	-21.3	-0.1	31.2
Net debtor countries	-113	-86.9	-70.1	-68.5	-32.2	-42.2
Official financing	-12.1	-9.2	-4.6	-10	-9.7	-3.6
Private financing	-86.1	-67.9	-50.3	-39.3	-17	-32.8
Diversified financing	-17.4	-15	-16.9	-16.3	-8.7	-6.5
Net debtor countries by debt-						
Servicing experience						
Countries with arrears and/or						
Rescheduling during 1994-98	-48	-41.4	-48.8	-57.3	-29.7	-23.8
Other net debtor countries	-65.2	-45.9	-22	-11.4	-2.9	-18.9
Countries in transition	-1.8	-16.9	-26.1	-24.8	-5.3	-7.5
Central and Eastern Europe	-4.9	-16.8	-19.4	-22.4	-22.5	-23.3
Excluding Belarus and Ukraine	-2.9	-15.1	-17.2	-20.2	-22	-21.6
Russia	4.6	3.8	-3	2.5	19.8	18.7
Transcaucasus and central Asia	-1.6	-3.9	-3.7	-4.9	-2.6	-2.9
Total	-56.7	-47.6	8.8	-71.7	-171.7	-231.9
In per cent of total world current						
account transactions	-0.5	-0.4	0.1	-0.5	-1.2	-1.5
In per cent of world GDP	-0.2	-0.2	..	-0.2	-0.6	-0.7
Memorandum						
Emerging market countries, excluding						
Asian countries in surplus	-76.2	-75.6	-106.8	-172.3	-86.7	-61.4

Source: IMF World Economic Outlook, April 2000

Russia's current account swung into a large surplus of over US$19 billion buttressed by rising commodity revenues, notably oil receipts, the devaluation of the Rouble and an import substitution based recovery at home.

5. Capital flows

Capital flows continue to be of varying importance to **developing country** groupings. In the Asian countries, especially the Tiger economies,[23]high saving rates have reduced the importance of capital flows as a contributor to growth. Meanwhile, in Latin America, past fiscal excesses and relatively low savings rates have augmented its dependence on capital inflows. On the contrary, in Africa a confluence of factors, including high risk ratings, instability and sluggish growth have retarded capital inflows and the contribution that such flows could make to the growth process. Total long-term resource flows to developing countries contracted by 8.7 per cent in 1999 to US$290 billion, maintaining the downward trend since the Asian crisis (see Table 9 below). While official flows were up marginally by over 2 per cent, private capital flows fell by almost 11 per cent. Official flows fell following strong growth in 1998 when financial rescue packages were provided for some crisis-hit countries. Meanwhile, net private flows slipped in response to a freeze in gross flows from international capital markets.[24] An important factor in capital market developments in 1999, was the willingness of investors to differentiate markets based on investment risk. This was distinct from the 'herd-like' withdrawal from emerging markets after the Asian crisis, when even countries with relatively sound macroeconomic fundamentals and satisfactory risk profiles were badly affected. Private flows were adversely affected by significant withdrawal by institutional investors who were a significant source of capital during the 1990s. This was compounded by the corporate debt overhang in some Asian countries, especially Korea and Indonesia, poor investor sentiment towards Africa and anticipation of the potential risks posed by the year 2000 (Y2K) computer bug.

In the **East Asian crisis economies**, improved investor confidence in some countries led to a rebound in net resource flows. These flows increased by US$6 billion in 1999, after falling by US$45 billion in 1998. Notably, portfolio equity flows more than doubled to US$19 billion, but were offset by a decline in foreign direct investment (FDI) and other flows. However, comparatively low investment outlays and the debt overhang of some large corporations means that capital flows to East Asia remains demand constrained. In **South Asia**, however, net resource flows fell by US$11.8 billion in 1999. Net private debt flows were hardest hit, declining from US$3.6 billion in 1998 to US$0.4 billion in 1999. Bank loans remained stable, but net portfolio equity flows surged, influenced by the booming Indian stock market, buoyed by a fast growing, dynamic software industry that is now well integrated into the global information technology sector. In addition, the high valuations of Indian software companies that have listed in the United States have had a strongly positive effect on the domestic market in India. Net private flows to India expanded by over US$4.0 billion in 1999, compared with only US$0.4 billion in Pakistan. A particularly favourable development for growth prospects and poverty alleviation in South Asia, has been the marked shift in the composition of resource flows in favour of foreign direct investment during the 1990s. FDI inflows rose from 17 per cent of net private flows in 1993 to 70 per cent of these flows in 1999. Meanwhile, debt flows dropped from 51 per cent of net private flows to 8 per cent over the same period. Given the stronger growth and employment stimulus provided by FDI flows, this pattern should help to alleviate the equity gap in these countries.

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[23] The Asian Tiger economies are the Republic of Korea, Hong Kong, Singapore and Taiwan.

[24] International capital market flows comprise mainly bonds, bank lending and portfolio equity holdings.

TABLE 9: Net long-term flows to developing countries, 1990-1999
(billions of U.S. dollars)

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
Total	98.5	124	153.7	219.2	220.4	257.2	313.1	343.7	318.3	290.7
Official flows	55.9	62.3	54	53.4	45.9	53.9	31	39.9	50.6	52
Private flows	42.6	61.6	99.7	165.8	174.5	203.3	282.1	303.9	267.7	238.7
International capital markets	18.5	26.4	52.2	99.8	85.7	98.3	151.3	133.6	96.8	46.7
Debt flows	15.7	18.8	38.1	48.8	50.5	62.2	102.1	103.4	81.2	19.1
Bank lending	3.2	5	16.4	3.5	8.8	30.4	37.5	51.6	44.6	-11.4
Bond financing	1.2	10.9	11.1	36.6	38.2	30.8	62.4	48.9	39.7	25
Other	11.3	2.8	10.7	8.7	3.5	1	2.2	3	-3.1	5.5
Equity	2.8	7.6	14.1	51	35.2	36.1	49.2	30.2	15.6	27.6
Foreign direct investment	24.1	35.3	47.5	66	88.8	105	130.8	170.3	170.9	192

Note: Net long-term resource flows are defined as net liability transactions original maturity of greater than one year, the Republic of Korea,
a high-income country which borrows from the World Bank, is included.
Source: World Bank Debtor Reporting System

There was a welcome recovery in resource flows to **Sub-Saharan Africa**. These flows increased by almost 20 per cent in 1999, compared with 1998. The relatively strong rebound in private flows helped to offset a small decline in official flows. Most of the increase in private flows went to South Africa, where inflows tripled from US$1.0 billion in 1998 to US$3 billion in 1999. However, two thirds of South Africa's inflows were debt-related, and reflect the limited ability of Africa to attract much needed equity flows, a manifestation, in part, of the shallowness of its stock markets and perceptions of high risk. Other countries in the region, including Nigeria, Ghana and Mozambique, also attracted higher inflows. As a manifestation of the over dependence on primary commodities, resource extraction and processing, particularly oil, was the main beneficiary of private flows. Interestingly, the overwhelming share of flows to Sub-Saharan Africa were FDI flows, but with the very limited development of competitive manufactured exports, the benefit of these flows to the region has been sub-optimal. In 1999, some flows also went to infrastructure, telecommunication and transport in line with privatisation opportunities and an improved investment climate in some countries. Unlike private flows, Official Development Assistance (ODA) aid flows remained stagnant in 1999, at around US$12 billion. ODA flows were negatively impacted by a fall in concessional loans from multilateral sources.

Latin America and the Caribbean remains an important capital deficit region. In these countries, inadequate domestic savings both private and public, have made capital inflows an important contributor to domestic absorption and growth. In 1999, net resource flows to the region fell by about 30 per cent to US$107 billion, the lowest level since 1996. Net lending from private creditors was particularly hard hit and plummeted from US$56 billion in 1998 to US$5 billion in 1999. Similar to other regions, notably South Asia and Africa, foreign direct investment has become the primary source of finance in Latin America and the Caribbean. FDI flows surged to a record US$89 billion in 1999. Importantly, Latin America receives more than half of the FDI flows to developing countries. In the region, privatisation and cross-border mergers and acquisitions provided the impetus to the boom in flows. In fact, Brazil, Argentina and Mexico are now the second, third and fourth largest recipients of FDI among low and middle-income countries. In 1999, FDI flows to Brazil reached US$30 billion, while Argentina and Mexico attracted flows of US$23 billion and US$10 billion, respectively. A disturbing development was the lack of start-up or green-field ventures in the composition of FDI, which hold greater potential for inducing growth and employment than mergers and acquisitions.

Underscoring improved perceptions of risk and the abatement of the effects of the 'flight to quality in 1998, net portfolio equity flows to Latin America and the Caribbean doubled to US$3.6 billion in 1999. However, these flows remained subdued compared with the average of about US$11 billion between 1994-97. Net official development finance, however, declined by roughly 8 per cent to US$9.3 billion in 1999.

Middle East and North African countries have not been very large users of external finance historically, since they had accumulated huge foreign exchange reserves from oil receipts. The fallout from the Asian crisis, however, and the sharp decline in oil prices in 1998, prior to their recovery in 1999, led to increased demand for external finance by these countries. Indeed, in 1999, net resource flows to the region almost doubled to about US$20 billion. This greatly surpasses the average of US$8.7 billion between 1990-97. Private flows rebounded, accounting for 40 per cent (US$8 billion) of the total. Oil exporting countries absorbed the lion's share of this private commercial debt that was used to smooth consumption in the wake of the shortfalls in export and fiscal revenues, consequent on the fall in the price of oil in 1998. Lebanon made an important foray into the bond market with issues of about US$1.5 billion. In addition, non-debt private flows also rebounded to reach US$9 billion in 1999. FDI was up by more than 3 billion. The bulk of these flows went to Saudi Arabia, Egypt and Tunisia, primarily for investment in the hydrocarbons sector. However, in an effort to encourage economic diversification, a portion was used by privatised State enterprises to boost non-oil exports. Reflecting stock market weakness in Egypt, Morocco and other countries, portfolio flows declined to US$0.6 billion. By contrast, official development finance expanded by more than 50 per cent to US$3.2 billion. This improvement was underpinned by the rescheduling of debt repayment by the Islamic Republic of Iran and Jordan. Jordan negotiated an agreement with the Paris Club to reschedule US$821 million of multilateral debt that was due in 1999.

The after shocks from the Russian financial crisis impacted adversely on net resource flows to Europe and Central Asia, especially the Commonwealth of Independent States (CIS). Aggregate net resource flows to the region fell sharply by over 22 per cent to US$45 billion in 1999. Private capital flows, influenced by investor disenchantment with the risk profile of the region, dropped by US$15 billion. Net private flows to Russia collapsed from US$19.3 billion in 1998 to US$1.9 billion in 1999, in the wake of its liquidity problems. Private flows to Hungary also declined, while Turkey witnessed a doubling of its net private flows to US$3.3 billion. FDI flows remained high and stable as in 1998. FDI flows were bolstered by the privatisation programmes that were undertaken in Central Europe, especially in Poland and the Czech Republic, where inflows were US$7 billion and US$4 billion, respectively.

6. External debt and debt reduction initiatives

Growth in the external debt of **developing countries** slowed to 1.6 per cent in 1999, down from 6.9 per cent in 1998 (see Table 10). Aggregate external debt for these countries amounted to about US$2038 billion. Total external debt grew at varying rates in the different subregions, reflecting domestic financing constraints and debt dependence. The external debt of the **Middle East and Europe** increased by 3.9 per cent, the fastest of the regional groups. The financing requirements in these countries were higher than usual in 1999, as a result of the fall in oil prices in 1998. Most of the increase in debt consisted of private commercial debt. The debt of these countries has been increasing fairly rapidly in recent times, with annual average growth of almost 6 per cent between 1994 and 1999.

Africa's external debt increased to 2.3 per cent in the year under review, compared with a marginal increase of 0.4 per cent in 1998. North African countries acquired higher levels of debt to buffer the adverse effects of lower oil prices in 1998, on aggregate demand. Meanwhile, by contrast, outstanding debt remained fairly stable in Sub-Saharan Africa, at around US$231 billion. Long-term debt accounted for 78 per cent of the total and publicly guaranteed debt represented 74 per cent. Unfortunately, though, net transfers[25] stood at negative US$2.7 billion. Negative net transfers mean that significant resources continue to flow from the least developed countries in Africa to meet debt service obligations, posing a major constraint to the availability of scarce resources for investment, growth and development. A welcome turn of events, was the growth in private lending, which actually accounted for almost 75 per cent of the total external credit, since this window had been badly affected by investor confidence in recent times. Moreover, no arrears on debt repayments were accumulated during the year as countries duly discharged these obligations. Debt service payments for the whole of Africa rose marginally to US$29.2 billion, following a decline of almost 6 per cent in 1998. Sub-Saharan Africa's obligations represented roughly half of the total, made up of US$9.0 billion of amortisation and US$5 billion of interest payments.

The total external debt of the **Asian developing countries** was up by 1.5 per cent, to US$671 billion in 1999. In East Asia and the Pacific (including China), long-term debt rose by 2.7 per cent to US$531 billion.

Latin America and the Caribbean is still the region with the largest aggregate external debt, but in 1999 its debt registered the slowest growth, rising by only 0.5 per cent to US$759.9 billion, after rather strong growth of 12 per cent in 1998. In 1999, a decline in debt to private creditors of roughly US$2.7 billion was compensated for by an increase in official debt, in keeping with growth in financing from multilateral institutions. Private debt was down largely on account of reduced commercial bank debt to Brazil reflecting, in part, lower trade flows and financing within MERCOSUR. In addition, bonds owed to the private sector declined in Argentina and Mexico. Meanwhile, growth in debt service payments by the region escalated by 13 per cent to US$168.9 billion, following a decline of 1.9 per cent in 1998. Moreover, debt indicators worsened, with the ratio of external debt to GNP rising to 46.2 per cent, the highest level for the decade and second only to Sub-Saharan Africa. Debt to exports, however, fell to 195 per cent from 211 per cent in 1998, the result of strong export receipts.

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[25] Net transfers are debt disbursements minus total debt service payments, and represent the net inflow to or outflow from a country.

TABLE 10: Summary of external debt and debt service (US$ billions)

	1992	1993	1994	1995	1996	1997	1998	1999
External debt								
Developing countries	1349.7	1472.7	1585.2	1713.9	1798.0	1877.6	2006.7	2038.2
Regional Groups								
Africa	262.3	272.2	289.1	311.7	310.3	303.3	304.6	311.5
Asian	404.3	456.3	510.4	562.8	595.1	642.5	661.2	671.0
Middle East and Europe	204.4	220.5	223.7	221.1	242.1	256.7	284.5	295.7
Western Hemisphere	478.7	523.7	562.0	617.3	650.6	675.1	756.4	759.9
Analytical groups								
By external finance source								
Net Creditor countries	38.9	42.3	41.1	30.7	49.3	61.1	74.4	78.8
Net debtor countries	1313.7	1433.3	1547.0	1686.2	1751.6	1819.3	1935.2	1962.2
Official financing	162.3	169.2	180.1	190.6	194.4	189.7	192.8	193.8
Private financing	914.5	1000.8	1084.4	1199.8	1264.5	1339.0	1442.4	1456.2
Diversified financing	212.1	229.0	247.3	260.2	262.0	262.8	272.4	284.0
Net debtor countries by debt-								
Servicing experience								
Countries with arrears and/or								
Rescheduling during 1994-98	589.1	628.0	665.0	707.8	732.9	753.9	810.1	815.9
Other net debtor countries	721.9	802.6	879.2	975.6	1016.0	1062.8	1122.4	1143.7
Countries in transition	211.7	233.8	248.7	267.2	285.7	297.9	347.1	353.0
Central and Eastern Europe	104.5	116.2	121.5	137.1	147.6	157.4	175.1	184.6
Excluding Belarus and Ukraine	100.4	110.5	112.2	126.3	135.8	141.2	160.0	169.7
Russia	105.4	112.7	119.8	120.4	125.0	123.5	152.4	148.1
Transcaucasus and central Asia	1.8	4.9	7.4	9.7	13.1	17.0	19.6	20.3
Debt-service payments								
Developing countries	178.7	178.3	196.8	236.7	276.4	306.6	612.0	347.0
Regional Groups								
Africa	29.9	28.1	29.3	33.8	30.8	30.9	29.1	29.2
Asian	53.0	53.1	63.0	76.8	76.3	81.7	96.6	109.2
Middle East and Europe	23.0	25.6	27.0	29.3	45.9	41.6	36.9	39.8
Western Hemisphere	72.8	71.5	77.6	96.9	123.5	152.4	149.5	168.9
Analytical groups								
By external finance source								
Net Creditor countries	2.5	3.7	8.0	8.5	20.5	16.2	10.5	9.8
Net debtor countries	176.4	174.7	189.0	228.5	256.2	290.6	301.8	337.5
Official financing	14.7	15.2	16.7	21.2	14.2	14.4	12.5	13.7
Private financing	135.1	136.3	148.2	179.0	209.4	243.0	256.9	291.4
Diversified financing	23.5	18.1	19.7	22.5	23.2	24.3	25.7	24.7
Net debtor countries by debt-								
Servicing experience								
Countries with arrears and/or								
Rescheduling during 1994-98	64.0	64.5	64.7	79.6	82.4	110.4	120.5	156.0
Other net debtor countries	112.2	110.1	124.2	148.7	173.6	179.9	181.1	181.3
Countries in transition	25.4	18.9	21.8	30.0	33.1	32.4	49.2	51.4
Central and Eastern Europe	12.7	12.4	16.9	21.9	24.7	24.6	29.2	34.0
Excluding Belarus and Ukraine	12.7	12.2	15.0	20.2	23.3	23.0	27.1	32.4
Russia	12.6	6.2	4.3	6.4	6.9	5.9	16.3	14.6
Transcaucasus and central Asia	0.1	0.3	0.6	1.7	1.5	1.9	3.7	2.7

Source: IMF World Economic Outlook, April, 2000.

7. Debt reduction initiatives

In 1999, further progress was made under the HIPCs Debt Initiative aimed at providing relief for poor countries which were pursuing good policies, but which still had unsustainable debt. Under the initiative, unsustainable debt was defined as a ratio of debt service to exports in excess of 25 per cent. Realistically, though, this ratio might even be too high for some of the poorest developing countries. In 1999, an enhanced HIPC programme was put in place to provide broader, deeper and faster debt relief, but the earlier programme that began in 1996 was continued. Under the earlier programme, debt relief forecasted to reach US$7.0 billion by early 2000 had been agreed to for seven countries - Bolivia, Burkina Faso, Côte d'Ivoire, Guyana, Mali, Mozambique and Uganda. Measures to strengthen coordination between official and multilateral creditors and to involve civil society in the framework have also been included. For Uganda, for instance, the combined HIPC initiatives are projected to reduce debt service payments to roughly 6 per cent in 2000-01, compared to 18.7 per cent prior to the start of the programme. In Guyana, debt reduction under the initiative has facilitated social spending, which has exceeded targets.

Reflecting the slow progress of the first initiative and the urgent need for improved debt relief, the international community designed an Enhanced HIPC Programme. The explicit focus of this new initiative is poverty reduction, rather than broad social spending. Also greater emphasis is placed on local 'ownership' of the programmes. Crucially, outcome-oriented, measurable goals are targeted to ensure the programme remains on track. Importantly, the maximum ratio of net present value[26] of debt to exports has been reduced from 200-250 per cent to 150 per cent. This has lowered the threshold, thus enabling more countries to qualify for relief and also increased the amount of debt relief. In addition, the sustainable ratio of the net present value of debt to fiscal revenue was lowered from 280 per cent to 250 per cent, while the exports to GDP benchmark was lowered from 40 per cent to 30 per cent. Also, the public revenue to GDP ratio was brought down from 20 to 15 per cent. All these changes have increased the number of eligible countries. Implementation is to be expedited by a floating completion point. This means that countries can accelerate the completion of the reforms and other requirements to qualify early for the disbursement of debt funds. Crucially, this allows debt relief to be provided based on policy performance and readiness, rather than a strict timetable. By early 2000, 14 countries have qualified for debt relief under the combined HIPC programme. However, by the end of 2000, the goal is to provide relief for about 23 countries.

The Paris Club also facilitated debt reduction with seven countries to the tune of US$16.0 billion in 1999. These countries included five low-income economies - Guyana, Honduras, Mozambique, Pakistan and Zambia, and two middle-income countries - Jordan and Russia. The Russian package represented more than half the total, with repayment phased over a 20-year period on a graduated payment schedule. Honduras and Zambia were provided rescheduling on Naples terms, that is, 67 per cent net present value (NPV) debt reduction that amounted to US$0.4 billion and US$1.1billion, respectively. Guyana and Mozambique got stock-of–debt reductions of US$0.2 billion and US$1.9 billion. In the case of Mozambique, this was particularly welcome to ease the hardships that resulted from the floods.

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[26] The net present value of the debt is net worth of the future stream of returns (discounted value) from projects undertaken with the debt funds in term of their current value minus the future stream of costs of the debt in terms of their current value.

VI. CONCLUSION

Following the sluggish performance in 1998, world economic and financial activity registered a welcome pick up in 1999. The United States economy, which was largely shielded from the downside effects of the Asian crisis, was the main driver of growth and activity. Unusually vibrant demand, especially consumer demand, larger than forecasted productivity growth, galvanised by efficiencies resulting from the use of information technology and strong equity returns, led the United States to provide the engine for world growth. Reaping the rewards of adjustment and restructuring, the Asian crisis economies also posted commendable recoveries - V-shaped in the case of the Republic of Korea.

In spite of the recovery, inherent weaknesses continue to plague the world economy, especially the least developed countries. Poverty, income and consumption inequality continue to be the bane of the world economy. In the post crisis period, poverty was aggravated even in the Asian economies that had made significant headway in tackling it. In Africa, the level of real per capita income today is lower than it was 30 years ago.[27] What is worse, the number of poor, living on less than $1 per day has remained more or less unchanged over the last decade. In addition, the volatility and low level of non-oil commodity prices on which many of the poor countries rely for income growth and consumption smoothing make these tasks the more difficult.

Although world economic growth is projected to pick up pace in 2000, to reach over 4.0 per cent, this is premised on a ‘soft landing’ of the United States economy, with United States growth increasing marginally by 0.2 per cent and equity prices coming down slowly and a gradual correction of the current account deficit. However, given the past history of equity price bubbles, matched by overspending, the landing might very well be harder than forecasted with adverse consequences for world growth. Any such hard landing in the United States and weakened demand in Europe and Asia is likely to severely affect other developing countries’ access to capital and export markets abroad, thereby aggravating an already serious poverty situation in these countries

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[27] See “World economic Outlook , 2000,” IMF